

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of

Implementation of the Pay Telephone  
Reclassification and Compensation Provisions  
Of the Telecommunications Act of 1996

Petition for Rulemaking or, in the Alternative,  
Petition to Address Referral Issues in Pending  
Rulemaking

CC Docket No. 96-128

DA 03-4027

**INITIAL COMMENTS OF T-NETIX, INC. AND EVERCOM SYSTEMS, INC.**

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Dated: May 2, 2007

## **SUMMARY**

The Alternative Rulemaking Proposal now advanced by inmate public interest advocates does not present a complete or economically accurate picture of the inmate telephone service industry. It is both redundant of existing proceedings and a premature regulatory mandate that Congress has never enacted. Though the public welfare goals Petitioners raise may have value, the Alternative Rulemaking Proposal does not provide an appropriate vehicle for imposition of a rate cap solely on inmate services, let alone the unsubstantiated rate element levels that Petitioners propose. Consequently, the Proposal should not be adopted.

As Dr. Richard Cabe explains in his Declaration accompanying these Comments, the Wright Petitioners' Alternative Rulemaking Proposal is based on flawed economic analysis and incorrect cost assumptions and, as such, presents the Commission with a regulatory regime that is unlawful from its inception — it would result in below-cost, confiscatory rates. In addition, driven largely by the simplistic Declaration of Douglas Dawson, the Proposal fails to consider that the inmate telephone industry faces more pronounced cost variations as well as significantly lower economies of scale, and thus its cost and rate structures cannot, as Petitioners contend, be analogized to long-distance telephone services provided to the general public.

Petitioners' concern about inmate welfare and the reduction of recidivism is well taken. Their policy position, however, is ultimately inconsistent with those laudatory goals. Mandatory nationwide rate caps will be extremely difficult to implement and are likely to prevent inmate telephone service providers from recovering their acknowledged costs of service. Carriers cannot be expected to remain in an industry that is subject to

below-cost pricing. Thus, as Dr. Cabe predicts, rate caps will significantly disrupt inmate telecommunications services.

Finally, T-NETIX and Evercom note that the public policy questions underlying the Alternative Rulemaking Proposal are more complex and far-reaching than Petitioners acknowledge. The issue of site commissions and their purpose presents a delicate balance of both penological and public finance objectives. Revenue to operate prisons and jails, which today secure unprecedented inmate populations, must be obtained somewhere. That need must be balanced against the need of inmates and their families to communicate. The matter cannot be solved quickly or easily, contrary to Petitioners' suggestion. In any event, to ignore the costs that site commissions impose on inmate telephone service providers or, more perversely, to punish carriers by mandating rate caps below the levels necessary to recover site commission costs, is not a proper or lawful course for this Commission to adopt.

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T-NETIX, Inc. (“T-NETIX”) and Evercom Systems, Inc. (“Evercom”), by their attorneys, submit these comments in response to the recent Alternative Rulemaking Proposal filed by the Wright Petitioners.<sup>1</sup> As we discuss in these comments and in the accompanying declaration of Richard Cabe, Ph.D. dated May 2, 2007 (“Cabe Decl.”),<sup>2</sup> a telecommunications economist who has participated actively in this docket, the Alternative Rulemaking Proposal advocates an unwise and unworkable regime for mandatory rate regulation based on deeply flawed assumptions about the financial and technical structure of this industry. The Proposal should be rejected.

**INTRODUCTION**

The Alternative Rulemaking Proposal is simply a belated replication of the Commission’s 2002 inquiry into inmate telephone rates.<sup>3</sup> Petitioners provide no more

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<sup>1</sup> By Public Notice released March 21, 2007, DA-07-1366, the Common Carrier Bureau extended the time for submission of initial comments on the Alternative Rulemaking Proposal until today.

<sup>2</sup> Attached hereto at Appendix A.

<sup>3</sup> *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Order on Remand and Notice of Proposed

grounds for rate caps now than inmate public interest advocates did five years ago. The Proposal simplistically mischaracterizes what is in fact a complex and far-reaching question: what would be the effect on correctional authority budgets and service providers' longevity if the industry were subject to mandatory rate regulation? This issue affects not only the business concerns of T-NETIX and Evercom, but also the public policy balance with which this industry has long grappled. The Proposal's myopic, naively-hopeful position that the FCC can resolve these complex issues with a rate cap "silver bullet" mandate is thus untenable.

As this Commission has long recognized, the inmate telephone industry faces "exceptional circumstances."<sup>4</sup> These circumstances are both operational, in terms of the unique security concerns with which prisons must deal, but also financial — this industry faces both inordinately high costs of service and remarkably low economies of scale. The Alternative Rulemaking Proposal fails to acknowledge either of these factors, and thus the Wright Petitioners' assumptions about the level of profit in this industry and its ability to survive rate regulation are flawed *ab initio*.

Dr. Richard Cabe, an economist specializing in telecommunications, explains in detail why the Alternative Rulemaking Proposal, and the Declaration of Douglas Dawson upon which it relies, presents an unworkable regime for inmate telephone service. It is also, for similar reasons and as further explained below, an unlawful measure that this Commission lacks the power to adopt.

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Rulemaking, FCC 02-39 (rel. Feb. 21, 2002), published at 67 Fed. Reg. 17036 (Apr. 9, 2002) ("Order on Remand").

<sup>4</sup> *Policies and Rules Concerning Operator Service Providers*, CC Docket No. 90-313, Report and Order, 6 FCC Rcd. 2744, 2752 ¶ 15 (1991) (holding that 47 U.S.C. § 226 requirements for unblocking of payphone "dial-around" calls do not apply to inmate phones), *aff'd*, *Amendment of Policies and Rules Concerning Operator Service Providers and Call Aggregators*, CC Docket No. 94-158, 10 FCC Rcd. 1533, 1534-35 (1995).

## **BACKGROUND**

T-NETIX and Evercom are providers of inmate telecommunications services and equipment serving correctional facilities throughout the United States.<sup>5</sup> Their services comprise payphone service, operator service, and local and long-distance voice communications services. T-NETIX has served inmates and correctional facilities since 1989, and Evercom began service in 1996. Together, these companies serve more than 2,900 correctional sites throughout the country and are the unquestioned leaders in developing patented technology for serving inmates and their families.

Having driven this market for more than two decades, T-NETIX and Evercom have extensive experience in the contracting and provisioning processes for inmate telecommunications services. They have seen, and largely pioneered, significant technological advances that have made service provisioning more efficient for facilities and less costly to carriers. Speaking here as one, T-NETIX and Evercom will demonstrate that the Alternative Rulemaking Proposal is not a workable solution in this industry. For even these companies, having a large geographic footprint and customer base, reap neither the so-called “excessive profits” nor “economies of scale” that Petitioners surmise.

As the Commission is aware, inmate telecommunications services are provided to a correctional facility through a single-carrier system, with exclusive contracts awarded pursuant to a public bidding process. This bidding process is typically supervised by the relevant authorized correctional agency, usually a state or a county. That body will release a Request for Proposals (“RFP”) that details the location(s) to be served, the type of service requested, and will provide several mandatory conditions with which the winning

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<sup>5</sup> Securus Technologies, Inc. is the holding company that owns 100% of the assets of T-NETIX and of Evercom.

bidder must comply.

The two principal obligations that RFPs typically include are the payment of site commissions and the maintenance of system security. In responding to an RFP, all carriers must certify that they can and will comply with these provisions should they win the contract. Thus, site commissions and security costs are an *unavoidable* component of doing business in the inmate services market.

The security requirements that correctional authorities require are extensive and detailed. Carriers must implement measures to block calls to specific numbers, to prevent three-way calling, and in many cases to impose automatic time limits on calls. These measures are necessary for the safety of correctional officers, inmates, as well as persons outside the prisons such as attorneys, judges and jurors. As with site commissions, compliance with these security requirements is universally required and non-negotiable.

One of the consequences of these security requirements is that service may be provided by only one carrier per each facility. Service options that are available to the general public, such as 0+ dial-around and 1-8XX collect services, cannot be available to inmates because they cannot ensure that inmate calls are subject to the necessary security requirements. For example, call blocking software would be entirely circumvented if an inmate were able to reach another carrier's platform.

Thus, the peculiar nature of inmate telecommunications services endows it with both competitive and non-competitive characteristics. The RFP bidding process is fully, and highly, competitive. Cabe Decl. ¶ 28. Once a contract is awarded, however, correctional regulations require that competition be displaced in favor of a single-provider system. The imposition of mandatory site commissions on this unique provisioning framework

necessarily has an effect on rates. That affect, however, is not untoward. Moreover, the complex policy underpinnings that inmate telephone service rates entail render the Alternative Rulemaking Proposal far less simple than Petitioners may hope.

## **DISCUSSION**

### **I. THE ALTERNATIVE RULEMAKING PROPOSAL IS UNTIMELY**

Petitioners have filed the Alternative Rulemaking Proposal at an awkward time, such that it is both redundant and premature. As mentioned above, the Commission in 2002 initiated a proceeding in this docket to examine precisely the issues that Petitioners have raised, and was confronted with the same policy dilemmas that are outlined here. The Commission has not been able to formulate its decision, possibly due to the complexity and gravity of the policy issues at stake. The present Alternative Rulemaking Proposal adds nothing to the inquiry, and as such is simply redundant of inquiries already outstanding at the Commission.

The Alternative Rulemaking Proposal is also premature. As Petitioners note, Representative Bobby Rush (D-IL) has introduced legislation, H.R. 555, that would require the FCC to consider whether and, if so how, to regulate rates for inmate telephone service. Petition at 4 & Exhibit E. Given the unprecedented regulatory measures that are now at issue, it is appropriate that Congress — which of course is the ultimate arbiter of interstate telecommunications policy — determine whether such action is necessary. The Petition simply prejudices those efforts, and attempts to set the Commission on a course that Congress may in fact not find appropriate.

T-NETIX and Evercom suggest that the Alternative Rulemaking Proposal be consolidated with the existing inmate rate inquiry in this docket and that the Commission

defer to Congress's review of this industry under the auspices of H.R. 555. To do otherwise would unnecessarily dissipate the Commission's limited resources and introduce rampant uncertainty to the inmate telephone services market.

## **II. PETITIONERS DO NOT UNDERSTAND THE COST STRUCTURE OF THE INMATE TELEPHONE INDUSTRY**

The Wright Petitioners argue that the inmate telephone industry enjoys unreasonable profits as well as tremendous economies of scale. Petition at 17-18. Dr. Cabe dispels each of these assumptions, demonstrating that in fact the inmate telephone industry faces not only exceptional operational requirements, but exceptional financial challenges as well. These circumstances, once appreciated, render the Alternative Rulemaking Proposal an ill-founded, unreasonable and unlawful proposition.

### **A. The Alternative Rulemaking Proposal Is Mistaken in Assuming That Inmate Service Providers Enjoy Economies of Scale**

Petitioners incorrectly assume that inmate telephone service providers enjoy "economies of scale," intimating that their cost scenarios mirror those of the carriers that serve the general population. Petition at 18. This assumption is dangerously incorrect. This industry remains, due largely to security requirements as well as the vast range in size and location of correctional facilities, very much a premises-based system.

Dr. Cabe explains that the inmate telephone industry substantially lacks economies of scale. He notes that, contrary to Dawson's assertion, T-NETIX and Evercom in fact are not able to reach any scale in operations, because for many costs each scale is defined "at the facility level." Cabe Decl. ¶ 18. Thus, to use Dr. Cabe's example, the costs of serving 100 facilities housing 30 inmates each is not the same as serving one facility housing 3000 inmates. *Id.*

The principal reason that economies of scale are difficult to attain is that the

secure calling platforms for inmate services are necessarily provided based on the individual requirements of each correctional facility served. It is not the case, as Dawson appears to assume, that having “customer bases of hundreds or thousands of correctional facilities” enables T-NETIX and Evercom to enjoy large economies of scale. Dawson Decl. ¶ 31; *see also* Petition at 18 (same text). To the contrary, each site has its unique requirements which will widely vary the software, storage, network facilities and other factors for each facility location.

Moreover, like all inmate providers, the obligation of T-NETIX and Evercom to comply with the individual needs of each prison or jail render economies of scale even further out of reach. T-NETIX and Evercom offer several different calling platforms, each with different capabilities and characteristics. The inmate phone industry is very much a business of customization. Each institution has its own penological needs and operational challenges, and thus each correctional authority requests that different features and settings be deployed for their facility. These are sunk costs at each site.

Dawson’s assertions about economies of scale appear to arise from his limited experience in inmate services that focuses only on long-distance provisioning. Dawson Decl. ¶ 2. His perspective seems to be that of an interexchange carrier (“IXC”) that need only deploy interoffice transport and a Class 5 switch to enter an entire metropolitan area. Inmate service providers, however, cannot and do not utilize that network model, and thus their sunk costs and incremental costs are plainly not comparable to those of IXCs. As such, the Dawson Declaration finds little application to this industry, and would not be a proper record on which to impose rate caps.

What is most telling about the Dawson Declaration is that its assumptions do

not correspond to Petitioners' own evidence. This failing is most apparent with regard to levels of site commissions. Dawson notes that T-NETIX must pay a 60% site commission under its contract with the Maryland Public Service Commission. Dawson Decl. ¶ 32. He also notes that his research indicates that site commissions add 43% "to all other costs before commissions." *Id.* ¶ 23. Yet Dawson's analysis allows only for a 30% site commission. *Id.* ¶ 24. From its inception, then, the Dawson Declaration *sub silentio* advocates the mandatory imposition of below-cost rates on inmate telephone service providers.

It is, however, well settled that the Commission is not permitted to impose below-cost rates on telecommunications providers. Even in the context of Congress's unbundling requirements under the Telecommunications Act of 1996, the Commission cannot impose rates that are "confiscatory" or "threatening to ... financial integrity." *Verizon v. FCC*, 535 U.S. 467, 524 (2001) (quoting *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 312 (1989)). In this industry, to take any action that would prohibit or prevent service providers from recovering their costs would indeed be confiscatory; this is a reality that must not be overlooked, regardless of how laudable Petitioners' societal and rehabilitation goals may be.

**B. The Alternative Rulemaking Proposal Grossly Understates the Cost Structure of This Industry**

Driven largely by the Dawson Declaration, the Proposal is mistaken about the cost structure of the inmate telephone service industry. Though Mr. Dawson states that he has experience in "the provisioning of long distance calling for prison inmates," his understanding of the cost structure of inmate telephones is flawed. As such, the conclusions he reaches, and that Petitioners advocate, with regard to the efficacy of rate caps are unreliable.

The principal failing of the Dawson Declaration is that it does not account for high-cost facilities. *See* Cabe Decl. ¶¶ 21, 25. These facilities include “the smallest facilities,” as well as “those located in remote areas” and “those with low calling volumes.” *Id.* ¶ 21. As explained in Section II.A above, each of these sites requires individual deployment and configuration of a calling platform in accordance with the needs of each correctional facility. For these reasons, inmate service providers face a wide range of costs, the higher end of which is not captured in the Dawson Declaration.

Dr. Cabe has reviewed closely the cost data on which Dawson relies, and finds that they “are clearly selected from the low cost end of the spectrum.” Cabe Decl. ¶ 21. In fact, Dawson admits that he excludes “higher inmate service rates,” Dawson Decl. ¶ 33, from his analysis, thus necessarily excluding sites that impose higher costs. Yet one cannot simply ignore the cost centers of this industry when considering whether to impose unprecedented rate regulation.

**C. The Dawson Declaration Does Not Acknowledge the Significant Research and Development Costs of This Industry**

The economic analysis in the Dawson Declaration contains a glaring omission: nowhere does he account for the costs of research and development (“R&D”) in this highly specialized, technology-dependent industry. Cabe Decl. ¶ 19. T-NETIX and Evercom have invested tens of millions of dollars in the patented technologies that they use to provide services, and remain the leader in invention and innovation for this industry. Relying on data from the Inmate Calling Service Providers Coalition, of which T-NETIX was not a member, Dawson fails to account for any such costs, presumably in an effort to paint as dramatic a portrait of “excessive profits” as possible. Dawson Decl. ¶ 18.

The Commission must be careful to ensure that the cost data it has been given

is both complete and realistic. With regard to R&D costs specifically, failure to properly account for these costs would have the perverse effect of discouraging innovation, thereby lowering carrier efficiency and putting upward pressure on inmate telephone rates. Petitioners' reliance on cost data that seems to exclude R&D costs, or in any event likely understates them, is an additional infirmity that endangers the very goals that their Alternative Rulemaking Proposal sought to bring forth.

### **III. RATE CAPS ARE NOT THE APPROPRIATE TOOL FOR REGULATING INMATE TELECOMMUNICATIONS SERVICES**

Petitioners seek “benchmark” rates for inmate telephone service; by any name, these would be rate caps. Petitioners characterize this relief as “simpler” than the Section 251-esque unbundling regime they proposed in 2004. Petition at 5. As Dr. Cabe demonstrates, however, rate caps are not only a complex solution for this industry, but they could force inmate providers out of the market. Cabe Decl. ¶¶ 21, 24-32.

#### **A. Rate Caps Will Not Be “Administratively Feasible”**

Petitioners argue, based on their simplistic view of the costs facing the inmate telephone service industry, that imposition of rate caps will be “far simpler” than the mandatory unbundling scheme they advocated three years ago. Petition at 4; *see also id.* at 15. But in fact, any attempt to impose a nationwide rate cap in this industry will be extremely difficult.

Rate caps are “ineffective or counterproductive.” Cabe Decl. ¶ 12. They would “impose a heavy regulatory burden on an industry that shows no indication of lack of competition.” *Id.* ¶ 24. As Dr. Cabe explains, their utility lies solely in setting the maximum rate that can be charged in any facility, regardless of whether the actual rates charged reflect a reasonable return. Concomitant with that purported advantage, however, are the negative

consequences that using such blunt instruments will impart.

Rate caps are also extremely difficult to set. As the Commission has found, inmate services entail a “great diversity of local costs and conditions,” *Order on Remand* ¶ 9, such that calibrating a federal rate cap would be a painstakingly detailed and slow process. Moreover, if it were set incorrectly, the consequences would be severe: too low a cap will force some carriers out of the market; too high a cap will invite excessive rates. Cabe Decl. ¶ 27. The inevitable result will be, much like the Commission’s endeavors to set a payphone compensation rate, a flurry of appeals and reconsiderations by both carriers and inmate advocacy groups alike.

#### **B. Rate Caps Will Prevent Carriers from Recovering Costs**

Petitioners’ call for rate caps will significantly injure the inmate telephone service industry. As noted in Section II.B above, the Alternative Rulemaking Proposal rests on economic analysis that does not properly account for the valid, fixed costs that inmate telephone service providers incur. Were the Commission to act on the Petition’s suggestion and analysis, it would subject this industry to a damaging and unlawful below-cost pricing regime.

Dr. Cabe makes clear that rate caps are too blunt a tool for the inmate services industry, based on the cost structures it faces. First, rate caps are unlikely to capture the cost variations that occur from region to region and from facility to facility. *See* Cabe Decl. ¶ 17. Fixed costs, which are the “lion’s share” of costs for this industry, “take on different values at different facilities.” *Id.* What Petitioners propose is a simple equation of  $\text{Cost} \div \text{Call Volume} = \text{Rate}$ . This equation does not work in a cost-varying industry, such as inmate telephone service, for the reasons discussed herein.

Second, rate caps, and in particular the specific cap Petitioners propose, will not allow inmate service providers to recover their legitimate costs. However Petitioners may feel about them, site commissions are real and meaningful costs to inmate service providers. Cabe Decl. ¶ 13. They cannot be ignored, and Petitioners cannot will them away.

Site commissions are a cost of doing business in this industry, and are required by correctional authorities in the overwhelming majority of contracts. Revenue from site commissions is targeted toward relieving the general tax base of some of the operational costs of prisons. Without these site commissions, some correctional facilities could be forced to remove their inmate telephone systems, because they simply would not have the funding to recover the costs to administer them. Indeed, several states have enacted legislation *requiring* correctional authorities to impose site commissions in order to recover administrative costs and to fund inmate programs. Like all other inmate service providers, T-NETIX and Evercom do not have the choice simply not to pay commissions; to do so would be to exit the inmate service market. Petitioners' proposal seems to punish inmate telephone service providers for remaining in this market.

Were nationwide rate caps adopted, “substantial disruption in the delivery of inmate communications service is likely.” Cabe Decl. ¶ 24. It is not reasonable for anyone to expect service providers, who, as Dawson concedes, carry an average site commission cost of 43%, not to recover the costs of service that their contracts impose on them. As stated above, the Commission must enable all telecommunications providers to recover their costs. *Verizon*, 535 U.S. at 524. The Alternative Rulemaking Proposal, which assumes away much of the actual site commission levels at work in this industry, would violate that fundamental regulatory precept.

**V. DEBIT CARDS ARE NOT UNIVERSALLY FEASIBLE AND DO NOT ELIMINATE COSTS TO THE EXTENT THAT PETITIONERS PRESUME**

Petitioners assume that debit cards will decrease carrier costs to such a degree that they must become the benchmark for inmate telephone services nationwide. Petition at 20-22. Although debit cards carry some advantages for both carriers and inmates, they do not represent a panacea for service rates. Rather, they present their own financial requirements, as well as security risks, and should not be viewed as the standard by which all inmate telephone services should be provided.

The chief advantage of debit cards is the reduction of bad debt. Because they are prepaid, debit cards allow carriers to receive full payment in advance. Carriers will realize this benefit, however, only if the facilities in which the debit cards option is offered strictly enforce the prepayment mechanism. Further, debit cards have no effect if only the persons who would otherwise pay bills in any case — the non-credit risks — switch to buying debit cards. Thus, advance payment reduces — but does not eliminate — carriers' bad debt, which often results in substantial loss to carriers in this particular market. Debit cards also alleviate somewhat the need for carriers to engage billing agencies and collection services, which impose additional — though lesser — costs on inmate service.

Debit card systems have their own unique costs, however. They require carriers to develop and install software that can query and verify the card holder's prepaid account. In addition, they entail new costs of manufacturing, distribution, and retail sale. These costs significantly diminish the overall savings that carriers may enjoy through the reduction in bad debt and billing costs. As such, debit cards should not be viewed as a guarantor of lower rates for inmate services.

In addition, debit cards create very real security risks that may deter facilities

from accepting them in the first instance. Debit cards are the equivalent of cash, and thus can become currency in the prison setting for which inmates may resort to violence.<sup>6</sup> Finally, the use of debit cards increases the administrative burden and costs to the correctional facility which must both manage the sale of the cards and administer the additional funding of the cards by the inmates, their friends, and their families. Under the Alternative Rulemaking Proposal, correctional facilities would thus be “hit” twice — their source of jail funding would be jeopardized while simultaneously increasing their administrative costs. The Commission should be mindful of these significant limitations and risks when considering the efficacy of debit cards in the prison context.

T-NETIX notes that its SecureVoice technology can assist in the use of prepaid accounts by protecting inmate Personal Identifier Numbers and relieving some administrative burden from correctional staff. *See* Petition at 24-25. That technology, however, is not necessarily suitable at all facilities, and T-NETIX and Evercom should not now be forced to deploy that technology in each of its sites. The recent deployment of SecureVoice demonstrates, however, that the inmate service industry is working diligently to improve its services and offer new technologies, an effort that Petitioners’ below-cost rate cap proposal significantly endangers.

For these reasons, T-NETIX and Evercom cannot agree that debit cards should become a nationwide mandate, nor should they become the benchmark for the cost structure of this industry. They result in very little cost avoidance and are fraught with implementation issues. To rely on debit cards as the basis for assessing the economics of this industry necessarily would result in a skewed and unworkable regime.

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<sup>6</sup> *See* T-NETIX Comments at 9-10 (May 24, 2002) (quoting Testimony of Michael Horcasitas, Manager in Policy and Law of Qwest Corporation at 4, NMPRC Case 3317 (Aug. 31, 2001)).

## **CONCLUSION**

For all these reasons, the Commission should reject the Alternative Rulemaking Proposal and should not apply mandatory rate caps to the inmate services industry.

Respectfully submitted,

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I, Stephanie A. Joyce, hereby certify that on this 2nd day of May, 2007, a copy of the foregoing Comments has been served via electronic mail (\*) or first class mail, postage pre-paid, to the following:

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